

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date:

29 OCT 1992

Employer Identification Number: [REDACTED]

Form: 1120

Tax Years: [REDACTED]

Dear Applicant:

This is a final adverse ruling as to your exempt status under section 501(c)(3) of the Internal Revenue Code.

This ruling is made for the following reason(s):

Based on all the facts and circumstances, we conclude that you do not qualify for recognition of exemption from federal income tax under section 501(a) of the Code as a cooperative hospital service organization under section 501(e), because you are not operated solely to perform, on a centralized basis, one or more specifically enumerated services for an exempt hospital. You are not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. You are operated for a substantial non-exempt commercial purpose. Furthermore, you are a feeder organization within the meaning of section 502.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file federal income tax returns on the above form. Based on the financial information you furnished, it appears that returns should be filed for the tax years shown above. You should file these returns with your key District Director for exempt organization matters within 30 days from the date of this letter, unless a request for an extension of time is granted. Returns for later tax years should be filed with the appropriate service center as indicated in the instructions for those returns.

[REDACTED]

If you decide to contest this ruling under the declaratory judgment provisions of section 7428 of the Code, you must initiate a suit in the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia before the 91st day after the date that this ruling was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Processing of income tax returns and assessment of any taxes due will not be delayed because a declaratory judgment suit has been filed under section 7428.

In accordance with section 6104(c) of the Code, the appropriate State officials will be notified of this action.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown above.

Sincerely,

(signed) [REDACTED]
[REDACTED]

Director, Exempt Organizations
Technical Division

cc: [REDACTED]

cc: [REDACTED]

cc: State officials

Code: [REDACTED]
Surname: [REDACTED]
Date: 10/23/92 10-26-92

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date:

23 JAN 1992

Dear Applicant:

. We have considered your application for recognition of exemption from federal income tax under section 501(e) of the Internal Revenue Code. We have concluded that you do not qualify as a cooperative hospital service organization within the meaning of section 501(e).

You were incorporated on [REDACTED], under the laws of the State of [REDACTED]. Your purposes, as stated in your Articles, are to be organized and operated exclusively for charitable purposes within the meaning of section 501(e) of the Code, with the more specific purpose of performing, on a centralized basis for hospitals, billing and collection services. Your Articles further provide that you shall have members. Membership is limited to hospitals which meet the requirements specified in your by-laws and those specified in section 501(e). You will not offer your services to hospitals other than members.

You will purchase eligible receivables from your members pursuant to contracts between you and each member. You will purchase receivables from members at a discount. The amount of discount represents compensation paid by the members to you for billing and collection services. Receivables will be purchased prior to the time that any bill is transmitted to the obligor on the receivable. You will then prepare and submit bills to the obligors for the purchased receivables and engage in collection activities. You will conduct these billing and collection activities through your employees and independent contractors.

Eligibility criteria for receivables to be purchased by you include the following: (1) the receivable must not be subject to any lien or counterclaim; (2) the receivable must be a legal, valid and binding obligation of the obligor; (3) the receivable must have been in existence for no longer than 180 days after the date of the last service for the patient; and (4) the information furnished by the member who sells the receivable to

you must be true and correct. A member who sells a receivable to you will be required to repurchase it only if it is subsequently determined that the receivable did not meet the eligibility requirements. Receivables purchased by you will be those generated by member hospitals in the ordinary course of their business as hospitals. If the eligibility criteria for the purchase of receivables is met, the patron who sells the receivable to you will have no obligation or right to repurchase it. Default risk and all expenses relating to billing and collection will be borne by you.

The obligors on the receivables (other than Medicare or Medicaid receivables) will be notified of the transfer of the receivables and will be expected to send payments directly to you. However, because of the requirements imposed by [REDACTED], payments on Medicare and Medicaid receivables must be made to the provider of the health care services. Consequently, payments on any Medicare or Medicaid receivables purchased by you will be sent to the member hospital which rendered the services. The member hospital will be obligated to deposit the payments into a bank account controlled by you.

Your purchase of receivables will be financed through the issuance of tax-exempt bonds by [REDACTED], which is a governmental unit of the State of [REDACTED]. The Authority will loan the bond proceeds to you. You will use them to acquire receivables from member hospitals and pay other bond-related expenses. You will repay the bonds with the money realized from the collection of the purchased receivables.

Section 501(a) of the Code provides in pertinent part that an organization described in subsection (c) shall be exempt from taxation unless such exemption is denied under section 502.

Section 501(c)(3) of the Code describes, in part, organizations organized and operated exclusively for charitable purposes.

Section 501(e) of the Code provides that an organization shall be treated as an organization organized and operated exclusively for charitable purposes if:

(1) such organization is organized and operated solely -
(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing (including the purchasing of insurance on a group

basis), warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and (B) to perform such services solely for two or more hospitals each of which is (i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a), (ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or (iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8 1/2 months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt under section 501.

Section 1.501(e)-1(a) of the Income Tax Regulations provides that section 501(e) is the exclusive and controlling section under which a cooperative hospital service organization can qualify as a charitable organization. To qualify for tax-exempt status, the organization must (1) be organized and operated on a cooperative basis, (2) perform, on a centralized basis, only one or more specifically enumerated services which, if performed directly by a tax-exempt hospital, would constitute activities in the exercise or performance of the purpose or function constituting the basis for its exemption, and (3) perform such service(s) solely for two or more patron-hospitals.

Section 1.501(e)-1(c)(1) of the regulations lists the permissible services: data processing, purchasing (including the purchasing and dispensing of drugs and pharmaceuticals to patron-hospitals), warehousing, billing and collection, food, clinical (including radiology), industrial engineering (including the installation, maintenance and repair of biomedical and similar equipment), laboratory, printing, communications, record center, and personnel (including recruitment, selection, testing, training, education and placement of personnel) services. An organization is not described in section 501(e) if, in addition to or instead of one or more of these specified services, the organization performs any other service.

In HCSC-Laundry v. United States, 450 U.S. 1 (1981), the Supreme Court held that a cooperative hospital service organization cannot qualify for exemption from federal income taxation as a charitable organization under section 501(c)(3) of the Code, but instead may qualify only if it performs one of the services listed in section 501(e)(1)(A). The Court reasoned that since laundry service was deliberately omitted from the list of services in subsection (e), HCSC-Laundry is not entitled to tax-exempt status because it is organized to provide laundry services for exempt hospitals and an exempt ambulance service. As stated by the Court, "[I]t seems to us beyond dispute that subsection (e)(1)(A) of section 501, despite the seemingly broad general language of section (c)(3), specifies the types of hospital service organizations that are encompassed within the scope of section 501 as charitable organizations." 450 U.S. at 8.

In order to qualify as a cooperative hospital service organization under the provisions of section 501(e) of the Code, an organization must be organized and operated solely to perform one or more of the services specified in section 501(e)(1)(A) of the Code. As the Supreme Court noted in HCSC-Laundry v. United States, supra., Congress exclusively addressed the exemption of cooperative hospital service organizations under section 501(e). Each activity listed in section 501(e)(1)(A) is limited to those activities "which, if performed directly by a tax-exempt hospital, would constitute activities in the exercise or performance of the purpose or function constituting the basis for its exemption ..." H.R. Rep. No. 1533, 90th Cong., 2d Sess. (1968), 1968-2 C.B. 801, 814. Although a hospital would conduct billing and collection activities, a hospital would not need to purchase its receivables.

Your activities involve the purchase of the member-hospitals' eligible receivables. The purchased receivables have many conditions placed on them to be eligible for purchase. The obligors then make payments to you or to the third party contracted by you to handle the payments. You repay the Authority which loaned you the money to purchase the receivables from the member-hospitals. This service as conducted by you is outside those permitted under section 501(e) and section 1.501(e)-1(c)(1) of the regulations. Your purchasing of the receivables from the member-hospitals is other than the billing and collection services contemplated under section 501(e) of the Code. It is more of a trade or business conducted by you for contracted clients rather than a centralized service for patron-hospitals. You are therefore taxable under section 502 of the Code as a feeder organization.

Contributions to you are not deductible under section 170 of the Code.

You will expedite our receipt of your protest by using the following address:

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "a declaratory judgment or decree under this section shall not be issued in any

[REDACTED]

proceeding unless the Tax Court, Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Sincerely yours,

[REDACTED]

Chief, Exempt Organizations
Rulings Branch 1

cc: [REDACTED]

cc: [REDACTED]

cc: [REDACTED]